



Legislative Department Seattle City Council Memorandum

Date: May 7, 2013
To: Housing, Human Services, Health and Culture (HSHHC) Committee
From: Sara Belz, Council Central Staff
Subject: **Multifamily Tax Exemption Program (MFTE) – Decision Agenda**

On Wednesday, May 8, the HSHHC Committee will again discuss the MFTE program. As part of that discussion, staff will ask the Committee to provide direction on the program amendments they would like to see incorporated into a forthcoming ordinance to be developed by the Office of Housing (OH). Central Staff prepared the following decision agenda to help guide the Committee's conversation on May 8. At that time, Committee members may also want to propose additional amendments that are not discussed in this memorandum. Please note that no votes on specific legislative language will be taken on May 8.

Issue 1: Program Goals

Included in the Seattle Municipal Code (SMC) are nine established goals for the MFTE program (see below). The goals are fairly wide-ranging and not all MFTE projects are able to achieve all nine. Additionally, progress toward some of the goals (e.g., "stimulate new construction") may be difficult to gauge over time. Thus, the Committee may want to consider whether these goals are measureable, attainable, and/or continue to reflect the long-term objectives of the program.

Figure 1: MFTE Program Goals from SMC 5.73.010 [emphasis added]:

1. To encourage **more Multifamily Housing** opportunities within the City;
2. To **stimulate new construction** and the **rehabilitation of existing** vacant and underutilized buildings for Multifamily Housing;
3. To increase the supply of Multifamily Housing opportunities within the City for **low and moderate income households**;
4. To increase the **supply of Multifamily Housing opportunities in Urban Centers that are behind in meeting their 20-year residential growth targets**, based on Department of Planning and Development (DPD) statistics;
5. To **promote community development, affordable housing, and neighborhood revitalization** in Residential Targeted Areas;
6. To **preserve and protect buildings, objects, sites, and neighborhoods** with historic, cultural, architectural, engineering or geographic significance located within the City;
7. To encourage the **creation of both rental and homeownership housing for Seattle's workers** who have difficulty finding affordable housing within the City;
8. To **encourage the creation of mixed-income housing** that is affordable to households with a range of incomes in Residential Targeted Areas; and
9. To encourage the development of **Multifamily Housing along major transit corridors**.

Options	Considerations
1. No action; retain all existing program goals.	<ul style="list-style-type: none"> • The existing program goals lack hierarchy and cover a broad range of objectives. This complicates efforts to define what exactly the MFTE program is supposed to be accomplishing. • Many of the existing program goals are qualitative in nature, which can make program performance a challenge to evaluate.
2. Revise MFTE program goals to only include measurable goals with associated outcomes that can be tracked over time.	<ul style="list-style-type: none"> • Establishing more measurable goals for the MFTE program would make program performance easier to evaluate and track. • Quantitative goals alone may not fully capture the City's objectives for the MFTE program.
3. Revise MFTE program goals to focus on one or two specific themes (e.g., increasing the City's overall supply of multifamily housing, increasing the City's supply of affordable housing, increasing the supply of market rate and/or affordable housing in areas of the City that meet certain criteria.)	<ul style="list-style-type: none"> • Establishing more focused goals for the MFTE program could make the program easier to evaluate over time. • If the Committee is interested in pursuing this option, additional discussion between Councilmembers, OH, and the Mayor's office may be necessary in order to reach a collective agreement on what the more targeted goals of the program should be.

Committee Recommendation:

Issue 2: Geographic Span

Questions about MFTE program goals are tightly integrated with questions about the program's geographic span. State law requires that the program be targeted to areas that the City Council determines lack "sufficient available, desirable, and convenient ... housing, including affordable housing." The MFTE program currently operates in 39 Residential Targeted Areas (RTAs). These areas are largely (though not perfectly) contiguous with the City's urban centers and villages. In addition to promoting the production of affordable units in higher-rent areas, the MFTE program is also used to encourage development in neighborhoods with cooler real estate markets.

Options	Considerations
1. No action; retain all 39 RTAs.	<ul style="list-style-type: none"> • Extends MFTE eligibility to projects in all designated urban centers and villages, which is a well-understood and documented geography that is used by several City departments and programs. • Supports the construction of multifamily housing, including affordable multifamily housing, across a wide spectrum of Seattle neighborhoods. • Does not provide any added incentive for developers to build MFTE projects in specific subsets of RTAs where the City might be particularly interested in encouraging new multifamily development (e.g., slow growth areas, lower income areas, neighborhoods with high average rental costs).
2. Limit the geographic span of the MFTE program to urban centers and villages that have not met some share (e.g., 50%) of their adopted 20-year residential growth targets for 2024.	<ul style="list-style-type: none"> • Limiting MFTE eligibility to projects in urban centers and villages that have not yet met a specific share of their 2024 growth target could help to encourage development in some cooler market areas and away from neighborhoods that have already exceeded their 20-year goals. • The amount of progress a neighborhood has made toward achieving its 2024 growth target is not necessarily a strong indicator of its real estate market dynamics. For example, South Lake Union, Ravenna, and the Admiral district are all desirable neighborhoods that have not yet met 50% of their 2024 growth targets.
3. Limit the geographic span of the MFTE program to RTAs with lower median incomes and/or cooler real estate markets.	<ul style="list-style-type: none"> • Selection of this option could lead developers that might otherwise invest in more robust market areas to take on projects in lower income and/or transitional neighborhoods. • In some MFTE projects located in lower income neighborhoods, the difference between the market and affordable rents charged for residential units is relatively small. Thus, while the completion of such projects does increase the overall stock of new housing in neighborhoods that might not otherwise see much multifamily construction, it may not create much new affordability. Conversely, the difference between the market and affordable rents charged for

	residential units in MFTE projects in stronger market areas can be substantial.
4. Limit the geographic span of the MFTE program to RTAs with higher median incomes and/or stronger rental markets.	<ul style="list-style-type: none"> • Selection of this option would encourage the development of affordable rental units in areas of the City that might not otherwise see much construction of new low- and moderate-income housing. • Limiting MFTE eligibility to areas with robust real estate markets could result in the completion of even fewer multifamily projects in City's lower-income and cooler market areas.
5. Limit the geographic span of the MFTE program to established urban centers and villages.	<ul style="list-style-type: none"> • Limiting MFTE eligibility to projects in areas with established growth targets and neighborhood plans could make the program's impacts on specific areas of the City easier to track and evaluate over the long term. • A few RTAs (Dravus, portions of Delridge) encompass areas that do not overlap with the boundaries of any established urban center or village. Removing these areas from the list of RTAs could slow the pace of future multifamily development in portions of the City where the Council has previously expressed an interest in encouraging more residential construction.

Committee Recommendation:

Issue 3: Occupancy Assumption for One Bedroom Units

The maximum monthly rent that may be charged for an affordable one bedroom unit in an MFTE project is \$1,201* (see Figure 2 on p.6). This amount is derived, in part, from the assumption that such units are typically occupied by two-person households. However, in Seattle, the average occupancy of a one bedroom rental apartment is closer to 1.5. If the City were to maintain the 75% of area median income (AMI) limit that currently applies to one bedroom affordable units in MFTE projects but lower the assumed household size to 1.5, the maximum rent that could be charged for such units would fall from \$1,201 to \$1,120, a difference of \$81 per month.

The MFTE affordability limits for studio and two bedroom units assume such units are occupied, on average, by one- and three-person households, respectively. These assumptions are fairly reflective of what is currently playing out in the City's rental market.

Options	Considerations
1. No action; retain the existing occupancy assumption for affordable one bedroom units in MFTE projects.	<ul style="list-style-type: none"> • The current maximum rent that may be charged to tenants of affordable one bedroom units in MFTE projects is based on an occupancy assumption that is inconsistent with the average number of people that typically reside in such units. • The current maximum rent that may be charged to tenants of affordable one bedroom units in MFTE projects is about 7% higher than what they would be required to pay should the occupancy assumption for such units be reduced from 2 to 1.5.
2. Reduce the occupancy assumption for one bedroom affordable units in MFTE projects from two persons to 1.5 persons.	<ul style="list-style-type: none"> • Other affordable housing programs administered by the City already apply an average occupancy assumption of 1.5 persons for one bedroom units. • Reducing the maximum rent that may be charged for affordable one bedroom units in MFTE projects could result in fewer one bedroom units being developed in such projects.

Committee Recommendation:

Issue 4: Affordability Levels

Current MFTE affordability limits, including the maximum annual income that can be earned by tenants of affordable MFTE units and the maximum monthly rent that building owners may charge for such units, are summarized in Figure 2 on the following page. Figure 2 also compares 2013 MFTE rent limits to 2012 Dupre & Scott-reported market rent averages for residential units located in newer multifamily buildings (i.e., the type of buildings that typically participate in the MFTE program). Over the years, the Council has periodically amended the income limits that apply to renters of affordable residential units in MFTE projects. Those limits have ranged from just 60% of AMI, regardless of unit size, back in 2004, to 90% of AMI for a two bedroom unit in 2008. Current AMI thresholds became effective in early 2011.

Figure 2: Estimated Rent Impacts of the Current MFTE Program

Unit Size	AMI	Maximum Annual Income	MFTE Maximum Monthly Rent*	Reference: Market**	Rent Savings to Tenant	Rent Foregone by Owner***
Studio	65%	\$39,455	\$886	\$1,249	\$363	29%
1BR	75%	\$52,050	\$1,201	\$1,574	\$373	24%
2BR	85%	\$66,385	\$1,519	\$1,848	\$329	18%

*MFTE rents shown are for 2013. They are reduced to reflect a utility allowance of \$100 for studio and one bedroom units and \$140 for two bedroom units.

**Market rents based on Sept 2012 Dupre & Scott average rents for multifamily rental buildings constructed since 2008 in eight indicator areas.

***Represents the difference between revenue possible from MFTE-restricted rents vs. average market rents.

Options	Considerations
1. No action; retain the income limits that currently apply to tenants of affordable units in MFTE projects.	<ul style="list-style-type: none"> • Since Seattle's MFTE program was first established in 1998, the City has revised the income limits that apply to affordable units in MFTE projects every two to four years. • The affordability limits for the MFTE program were last amended more than two years ago. Since then, the local residential construction industry has begun to rebound from the recession and the rental real estate market has grown increasingly strong. Thus, it is possible the income thresholds that currently apply to affordable units in MFTE projects may not be the most appropriate in the context of today's economy.
2. Request OH develop options for lowering the income thresholds for some or all unit sizes.	<ul style="list-style-type: none"> • Since the income thresholds for affordable MFTE units were last amended in early 2011, the program has remained very popular among Seattle's multifamily development community. This suggests that there may be some room to lower the affordability limits without substantially diminishing developer interest in the program. • If the income thresholds for MFTE units are significantly lowered, developer interest in the program is likely to decrease.

3. Request OH develop options for increasing the income thresholds for some or all unit sizes.	<ul style="list-style-type: none"> • The MFTE program is currently quite popular among Seattle’s multifamily residential developers. Thus, there is likely little evidence to suggest that the income thresholds for affordable MFTE units should be increased at this time. • It may still be helpful to have OH complete this analysis and provide Committee members with some additional context before a final decision on affordability limits is made.
4. Request OH develop options for assigning different affordability thresholds to different subsets of RTAs.	<ul style="list-style-type: none"> • Would allow the MFTE program to respond to varying housing needs and market dynamics in different parts of the City. • Selection of this option could make the MFTE program more challenging for OH to administer over time.

Committee Recommendation:

Issue 5: Percent of Units Affordable

To qualify for a 12-year tax exemption under the MFTE program as established by State law, at least 20% of the housing units in a multifamily project must be classified as affordable (RCW 84.14.020). However, local governments have discretion to require a greater set-aside of affordable units. At the May 8 HSHC Committee meeting, OH staff will present a financial model that shows how increasing the share of affordable units in an example MFTE project to 25% could impact returns to the developer over time.

Options	Considerations
1. No action; continue to require at least 20% of the units in MFTE projects to be maintained as affordable.	<ul style="list-style-type: none"> • Maintaining the current set-aside of 20% could result in fewer affordable units per project but may lead more developers to take part in the program than would if a larger share of affordable units were required.
2. Require a greater share (e.g., 25%) of the residential units in MFTE projects to be set aside as affordable.	<ul style="list-style-type: none"> • A majority of the City’s MFTE projects are comprised of 50 or more residential units. Thus, increasing the required share of affordable units from 20% to 25% could have a real impact on the number of affordable units produced on a per-project basis.

	<ul style="list-style-type: none"> • If required to comply with a 25% set-aside requirement, some otherwise interested developers may elect to not take part in the program and instead build projects that are entirely comprised of market-rate housing.
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Committee Recommendation:

Issue 6: Unit Size Preferences

Over the past few years, developers of more than 1,500 very small studio units averaging around 200 square feet (microhousing) have applied for tax exemptions through the MFTE program. In addition, the average size of traditional studio apartments located in many MFTE projects appears to be on a decline. Due to their size, the market rents that can reasonably be charged for small studios units do not always exceed the maximum rent that can be charged for an affordable studio in an MFTE project. Thus, the owners of MFTE projects that include small studios may be able to retain most or the full value of their tax exemptions without having to reduce the monthly rents they charge for many of their units. Also, on a per-square-foot basis, the rents charged for small studio units are often higher than those charged for much larger apartments.

At the other end of the spectrum, the MFTE program's tiered affordability levels (lower for a studio, higher for two bedroom units) presently provide developers with a modest incentive to include two bedroom units in their buildings. However, no income threshold has yet been established for units with three or more bedrooms. Currently, the income and rent limits for two bedroom units are also applied to larger units when they are included in MFTE projects. As a result, building MFTE projects that include large, family-size apartments does not appeal to most developers.

Options	Considerations
1. No action; do not create new income thresholds that would apply to small studio units, including microhousing units, or units that have three or more bedrooms.	<ul style="list-style-type: none"> • Although the rents charged for microhousing and other small studio units often exceed those charged for larger apartments on a per-square-foot basis, they are generally much more affordable on an overall cost basis, even without the application of income restrictions. • Without a lower income restriction in place for microhousing and other small studio units, developers of such units will continue to be able retain most or all of the value of their tax exemptions without having to provide any additional affordability in return.

	<ul style="list-style-type: none"> Without an income threshold in place for affordable units with three or more bedrooms, it is likely that apartments of this size will remain an anomaly in MFTE projects.
2. Request OH develop and analyze income threshold options for affordable microhousing and small studio units in MFTE projects that do not exceed a certain size.	<ul style="list-style-type: none"> Creating a maximum income threshold for affordable microhousing and small studio units in MFTE projects would create more opportunities for lower income renters (potentially those earning around 50% of AMI) to benefit from the program. If a new income threshold is created for affordable microhousing and other small studio units, it is possible that fewer such units may be developed as part of MFTE projects.
3. Request OH develop and analyze income threshold options that could be applied to affordable units in MFTE projects that have three or more bedrooms.	<ul style="list-style-type: none"> If an income threshold is designated for affordable units with three or more bedrooms, it is possible that more such units may be developed in MFTE projects.

Committee Recommendation:

Issue 7: Student Eligibility

In its 2012 review of the MFTE program, the Office of the City Auditor questioned whether all full-time students, some of whom may be receiving significant financial support from their families, should be eligible to occupy income-restricted units in MFTE projects. In response, the City could, for example, choose to exclude full-time students who are claimed as dependents on another party's tax return. Under the current language in the SMC, OH has no basis to prevent any type of tenant from occupying an affordable unit in an MFTE project, so establishing a restriction on student residents would require Council action via ordinance.

Options	Considerations
1. No action; do not place any restrictions on the ability of income-eligible students' to rent affordable units in MFTE projects.	<ul style="list-style-type: none"> Full-time students comprise a relatively small share of the residents living in affordable rental units in MFTE projects. The tuition and living expenses of some full-time students are entirely covered by family members and

	<p>other people in their lives. Thus, while their total incomes may qualify them to occupy affordable rental units in MFTE projects, they do not fit the profile of the type of low- or moderate-income renter the program was intended to serve (i.e., employed, modest-wage workers).</p>
<p>2. Prohibit households comprised of full-time students who are claimed as dependents on another party's tax return from renting affordable units in MFTE buildings.</p>	<ul style="list-style-type: none"> • Selection of this option would prevent some full-time students that receive substantial financial support from their families from occupying designated affordable units in MFTE projects. • Selection of this option could also result in the exclusion of some full-time students who support themselves with revenue sources other than financial assistance from their families (e.g., student loans, income from part-time jobs, work-study). • Some full-time students who receive substantial financial support from parents, other relatives and friends are not claimed as dependents on another party's tax return.

Committee Recommendation:

Issue 8: Income Requalification

At present, the SMC requires prospective tenants of affordable units in MFTE projects to income-qualify at the point of move-in. In its 2012 review of the MFTE program, the City Auditor raised the questions of whether 1) such tenants should be required to periodically re-qualify for their units, and 2) building owners should be obligated to designate alternate affordable units within their MFTE projects when tenants' incomes grow to exceed the maximum thresholds established for the program.

Options	Considerations
<p>1. No action; do not require income-qualified tenants of MFTE projects to periodically prequalify for their affordable units.</p>	<ul style="list-style-type: none"> • Analysis completed by OH staff suggests the average length of tenancy for households residing in affordable rental units in MFTE projects is about 14 months. Thus, cases of tenants occupying affordable MFTE units and earning more than the maximum permitted income for extended periods of time are probably fairly limited.

	<ul style="list-style-type: none"> Without an income review or requalification system in place, any abuses of the program that are occurring will be harder to detect or address.
2. Require tenants of income-restricted units in MFTE projects to periodically re-qualify for their units, perhaps once every two years. When a tenant is found to no longer income-qualify for their unit, require the building owner to designate an alternate affordable unit on-site.	<ul style="list-style-type: none"> Selection of this option would expedite the creation of a process that could help to address and rectify any abuses of the MFTE program that may be occurring at participating buildings. Establishing a process for requalifying tenants of affordable MFTE units, and training building owners and managers to carry out that process, could require significant staff resources that are beyond OH's current capacity. One alternative option would be to implement a requalification process in a small subset of MFTE buildings in order to gauge whether abuses are occurring before applying a new process standard in all MFTE projects.
3. Oblige OH to make building owners responsible for collecting the annual tax returns of income-qualified tenants and provide the Council with regular updates on the incidence of tenants' incomes substantially increasing after the point of move-in.	<ul style="list-style-type: none"> This option could be easier for OH and building owners to implement in the near-term and allow the Council to review some initial data before deciding whether to require the implementation of a full income requalification process as described under Option 2. If significant abuses are occurring, selection of this option will slow the pace of implementing a full requalification process.

Committee Recommendation:

Issue #9: Proposed Amendment to Extend MFTE Eligibility to a Multifamily Project that is Currently Ineligible

Chuck Wolfe, an attorney representing the developer of a multifamily residential building currently under construction in Southeast Seattle, has asked that the Committee consider amending the SMC to allow his client's project to participate in the MFTE program. Mr. Wolfe's client received their first building permit for their project sometime between July 22, 2007, and August 6, 2008. From August 2008 until April 2011, the SMC permitted developers

of projects that received their first building permit between July 22, 2007, and August 6, 2008, to apply for a tax exemption via the MFTE program at any time prior to the completion of their project. In 2011, the SMC was amended to remove the reference to the time period between July 22, 2007, and August 6, 2008, and to require MFTE applications be submitted to OH no later than the date that a project's first building permit is issued. Mr. Wolfe's client had to put their project on hold for a few years during the recession and did not submit an application for a tax exemption before the SMC was amended in 2011. As a result, although their initial building permit was lawfully extended during the time their project was on hold, their project is not currently eligible for a tax exemption through the MFTE program.

Mr. Wolfe and his client would like to see the SMC amended in order to allow developers who received their first building permits for a multifamily residential project between July 22, 2007, and August 6, 2008, and who lawfully extended such permits, to apply for a tax exemption through the MFTE program at any time prior to the completion of their project. OH does not believe Mr. Wolfe's suggested amendment would impact any projects other than his client's. Mr. Wolfe will be present at the May 8 HHSHC Committee meeting to speak to his proposal.

Committee Recommendation:

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Next Steps

Following the May 8 Committee meeting, OH staff will begin assembling an ordinance that will propose policy changes to the City's MFTE program. Once complete, that legislative proposal will be submitted to the Council and referred to the HHSHC Committee for review.

If you have any questions about the content of this memorandum or the MFTE program more generally, please feel free to contact me at any time (sara.belz@seattle.gov / 4.5382).